

OFD/ED:GRKenney:ed
(Drafting Office and Officer)

DECLASSIFIED
CONFIDENTIAL

DEPARTMENT OF STATE

Memorandum of Conversation

March 10, 1961

DATE:

SUBJECT: Volta River Project: VALCO Financing Negotiations

PARTICIPANTS:

COPIES TO:

B - 2 ✓
L - 3 ✓
E - 3 ✓
OFD - 1 ✓
ED - 6 ✓
ICA - 3 ✓
Erim - 3 ✓
Treasury - 3 ✓
AF - 3 ✓
AF/W - 3 ✓
DLF - 3 ✓

DEPARTMENT OF STATE A/CDC/MR

REVIEWED BY *BS* DATE

PORTIONS DELETED AS INDICATED

4 MAY 1982

Participants:

Abram Chayes, Legal Adviser, Department of State
Harold Linder, President, Export-Import Bank
Frank Coffin, Managing Director, Development Loan Fund
Arthur McLaughlin, Deputy Director for Operations, DLF
Stanley Surrey, Assistant Secretary of Treasury for Tax Policy
Ralph Hirschtritt, Treasury Department
Peyton Kerr, Deputy Assistant Secretary of State for Economic Affairs
George Kenney, OFD/ED
Robert Eisenberg, AF/W
Chad Calhoun, Vice President, Kaiser Industries
Lloyd Cutler, Attorney for Aluminum Companies
George Woods, First Boston Corporation
Ronald Sullivan, Sullivan and Cromwell
Sam Stern, Sullivan and Cromwell

SENT BY AIR

DECLASSIFIED
CONFIDENTIAL

70% of this doc in RM/R destroyed

MAR 21 1961

FILED

RECEIVED THE

0400.2014/0-1001

OFD/ED:GRKenney:cd

(Drafting Office and Officer)

CONFIDENTIAL

DEPARTMENT OF STATE

845J.2614/3-1061

Memorandum of Conversation

DATE: March 10, 1961

SUBJECT: Volta River Project: VALCO Financing Negotiations

PARTICIPANTS:

(See Page 7)

COPIES TO:

B-2 ✓ ICA - 3 ✓
L - 3 ✓ Exin - 3 ✓
E - 3 ✓ Treasury - 3 ✓
OFD - 1 ✓ AF - 3 ✓
ED - 6 ✓ AF/W - 3 ✓

MAR 21 1961

845J.2614/3-1061

Mr. Chayes began the meeting by repeating his proposals of March 9 which may be summarized as follows:

The Government is meeting the companies' position on the amount of equity investment. One-half of the loan capital would be a direct loan from the United States Government and 75% of private loan capital would be guaranteed for repayment except for default caused by non-performance of their contract by the companies. On equity, a FRIA type guarantee plus risks of civil disorder and protection against economic sanctions the United States might levy against Ghana.

The above package had preliminary clearance by Mr. Ball but not by the Treasury Department and other agencies concerned, and the presence today of the Eximbank, DLF and Treasury representatives should not be interpreted as final approval by these agencies.

Mr. Woods said his role was that of financial advisor to the Kaiser Aluminum Company. The First Boston Corporation has done underwriting for Kaiser. On the debt problem either we will be able to obtain a lender or we will not. He suggested putting the debt problem aside for the moment to be looked at as soon as possible with prospective lenders. Most of Kaiser's

debt is held

DECLASSIFIED

MAY 1 - 1961

FILED

CLASSIFIED FILE

CONFIDENTIAL

- 2 -

debt is held by insurance companies, especially New York Life. In his experience he does not know of any case in which insurance companies made advance commitments of funds for more than 18 months to two years ahead.

Mr. Chayes preferred not to drop the debt discussion so quickly and asked what Mr. Woods proposed to do to look into the lending prospects. Mr. Woods thought a Vice President of First Boston could contact New York Life to get its reaction to the proposal. The company is familiar with Kaiser aluminum and its problems. So are Equitable Life and Metropolitan Life because they participate with the New York Life group in holding Kaiser's obligations. Mr. Woods thought that even if the equity problem were solved it would still take much time to negotiate loans with the insurance companies. He thought it would be better to have Eximbank put up the entire loan commitment with the understanding that every effort would be made by the Government and the consortium to bring in the insurance companies at a later date. He is afraid that negotiations would bog down because of the need for a three-year standby agreement. He would be surprised if the group could agree in as short a time as 60 days, but he is willing to start if necessary.

Mr. Linder thought the interest rates and fees would affect the outcome of the talks, but he was not sure why it should take so long since insurance companies are in a position to calculate the flow of their funds quite readily. Mr. Woods agreed that in principle the insurance companies should be willing to do this, but it is an unprecedented arrangement. The companies are trustees and should make investments in line with going rates in the market. Mr. Linder said something could be worked out to relate the standby arrangement to market conditions, and he had every confidence that Mr. Woods could be convincing in view of his success with the World Bank.

Mr. Cutler thought it would be desirable to settle the issue of covering the remaining 25% of the private debt against political risks before discussions with the lenders, but Mr. Woods thought it was just as well to leave the question open. Mr. Woods also thought that the first discussion between First Boston and the insurance companies should be without Government participation. Mr. Surrey raised the question whether the Government should not have a firmer clearance of the Government's proposals before the insurance companies are approached. Mr. Chayes thought there might be need for further preliminary clearance, but Mr. Linder thought it would be possible to go ahead with Mr. Woods' proposal without waiting. Mr. Woods agreed to sound out the lenders within the next week. He thought a better approximation of what the insurance companies will do is needed right away before the Government position becomes too firm.

Mr. Cutler then took up the equity question. He said the new government guaranty proposal goes beyond FRIA and comes close to meeting the companies' requirements, but there are two reactions from the companies.

The first

DECLASSIFIED

CONFIDENTIAL

- 3 -

The first is that they prefer to define the risks that are not covered rather than to define risks that are covered, and the second is that the companies still desire to be paid off on a partial loss basis. Of these two, the first is the more serious problem. (The discussion did not return to the second point.) Where risks that are covered are defined and listed, there remains a question for the companies concerning the scope of their protection. No court decisions have yet been made on political guarantee claims. It makes for more certainty from the investor's viewpoint if normal business risks are excluded instead of listing items covered. The companies are willing to pay for the certainty of coverage. The companies are willing to give up 10% of the amount of the loss covered in order to get this kind of certainty, i.e., they will accept 90% coverage. The companies then know how much they are risking - in this case \$3.2 million.

Mr. Chayes thought that labor relations presented a serious problem which in any event should be included in the "normal" risk category. Otherwise ordinary strikes could provide the occasion for the companies to bail out of a bad investment. Mr. Woods agreed that if, in the aggregate, problems were great and business were bad there is no doubt the door would be open for this. Nevertheless a mutually acceptable solution would be a considerable achievement because it would provide a new pattern in this field. Mr. Chayes said that had been the Government's position all along. For the companies it is a one time proposition, but from the Government's viewpoint a pattern will be established which we will have to live with.

Mr. Woods said the aluminum companies cannot be put in a position of getting all the profits while taking no risks. Still, it may not be feasible to work out a solution providing for some financial exposure. There should be something flowing to the equity holders representing the cost of raising \$12 million. There should be appropriate compensation to them for management services. The problem is how to divide the remainder between the Government and the owners of the common stock. Mr. Woods thought that a schedule could be drawn up with 10% exposure after the cost of money and a management fee had been taken into account and with the common share holder entitled to a specified percent of earnings. With 10% exposure there would be 10% plus some (unspecified) further proposition. With 20% exposure the implication would be 20% plus some higher (unspecified) proposition. It is necessary to weigh location factors, the state of the industry, and to decide on a project by project basis. Maybe the companies would prefer a 25% exposure to get a larger share of the profit. Where legal counsel on both sides try to define the types of risk covered, Mr. Woods was afraid the effect would break down because of the need for so many detailed negotiations. He is striving for a simple formula that the most unwilling director could live with. If a CPA can say to the Board "your exposure is \$3.2 million if you perform on your contract" the directors will buy. As regards Kaiser Aluminum he (Woods) and the management will have to adjust their thinking if the game of exceptions is begun. To avoid the grey areas is to avoid troubles.

Mr. Chayes

DECLASSIFIED

CONFIDENTIAL

- 4 -

Mr. Chayes said the Government believes that a partnership relationship and a guarantee relationship are different. Mr. Woods is talking about a co-venture. This implies direct equity investment by the Government, or a management contract, with the Government winding up with the plant. We need authority from Congress for this. If we go beyond the insurance approach we should do so directly - not under the cloak of a guarantee. There is no doubt that new combinations and arrangements are developing, and there is no disposition in the new Administration to be rigid or inflexible but, in the framework of the guarantee program, an agreement which sets a pattern will have to be defended to Congress and the public as a guarantee. The U.S. must say what kinds of risks have been assumed by the Government and these must be risks which Congress contemplated. Otherwise the guarantee cannot be defended.

Mr. Chayes also wished to question the assumption that defining the risks that are covered and excluding specific risks are reverse sides of the same coin. The Government's position is not cast in terms of the borderline of what may be covered and what must be excluded under the statute. This is more of a policy question than a legal question. On this basis we are entitled to a fee rather than a share in profits. Mr. Coffin added that he doubted the tactical wisdom of pushing DLF, for example, to the full extent of its authority in view of adverse Congressional attitudes towards a broadening of ICA authority. Mr. Chayes continued, saying it is unrealistic to talk about potential lawsuits on these guarantees. This is a possibility but we are presumed not to be at the mercy of an ad hoc judgment. We are willing to go so far but unwilling to say the U.S. will go to the limit of apparent statutory authority.

Mr. Linder wanted to reduce the problem to simpler terms. This project is not different from other operations except that the Government is lending with a smaller than usual ratio of equity to debt. There are unforeseeable political risks on the West Coast of Latin America and different kinds of risks in the Union of South Africa, for example, where investments have been made without guarantees and with larger percentages of equity. It is true the companies have agreed to take the aluminum output, but they would invite expropriation if they did not do so. The essential difference is a political risk, and the U.S. is not only prepared to cover the risk but more extensively than on other projects!

Mr. Chayes emphasized that when the companies could show a specific and definable political risk that is a reasonable proposition, the U.S. will cover it. But we cannot write a blank check.

Mr. Linder pointed out that Aluminium Limited would be unable to get guarantees for its Boko equity, and he also referred to Brazilian and Liberian projects, but the companies did not wish to discuss these matters. Mr. Woods stated flatly that the companies do not want to take any political risks in West Africa. In fact they don't really want the aluminum. The

companies

DECLASSIFIED

CONFIDENTIAL

- 5 -

companies which are not consortium leaders (Olin Mathieson, Reynolds, and Alcoa) can show that these projects are foolish. Hence the theory that insurance must be sought against all risks. Still, the aluminum companies will take less than a 100% guarantee on their equity. At one end of the spectrum, he sees Government ownership such as the wartime defense plant setup. With no real desire to go into business in West Africa, how can the companies participate with the Government on any terms other than as partners. This is what Mr. Woods would prefer, but the Government proposal implies a continuing grant to the Ghana Government by the U.S. instead of collecting profits. This is not a guaranty concept. However, if the Government is willing to go to the full extent permitted by the law on the debt side, why is the policy different for the equity?

Mr. Chayes replied that since the Government could lend all of the debt capital outright, there was no conceptual problem in its guaranteeing payment on a portion. With regard to equity, there is no Government-plant concept today. In fact the companies will get a plant with minor exposure. A sliding scale of profit-sharing seems attractive and simple, but there is no way of putting numbers in the blank spaces except through negotiations. The figures are arbitrary. The Government is staying in the insurance business. In the investment business profits would be shared in accordance with equity investment.

Mr. Cutler thought the companies could make a judgment concerning equitable shares under Mr. Woods' theory. Why does the Government charge flat fees? Mr. Chayes replied that the Government is not giving guarantees to make a profit on insurance, so the charge may be unrelated to the real value of the insurance. There are some political actions we believe present risks the companies shouldn't have to bear. This is a policy judgment by the U.S., and the guaranty program is therefore a political program. Some fee has to be charged.

In summary, Mr. Woods said the normal risk is to find a market. This risk has been assumed in the purchase agreement. Certain other risks are insurable commercially. All other risks are political.

At this point, Mr. Calhoun expressed confusion concerning the terms of our offer. Mr. Chayes said we had offered a FRIA-type guaranty against expropriation plus coverage of risks due to civil strife and insurrection and acts of the U.S. Government in the nature of economic sanctions. Our proposal excludes everything else.

Mr. Woods had to admit the offer to be generous. If the companies can think of other specific risks, he understands that the Government is willing to consider coverage. But in this day and age there are too many unknowns and too many plotters. People are different in Brazil, India and Pakistan.

Mr. Chayes

CONFIDENTIAL

DECLASSIFIED

CONFIDENTIAL

- 6 -

Mr. Chayes reviewed the semantics of the problem and reiterated the need to say plainly to Congress which risks the Government had obliged itself to take. We cannot write a blank check even if the possibility is implied in the statutory language. The major risks will be covered by our proposal.

Mr. Linder said he was sure that he and the companies could discover other kinds of "normal" risks if the effort were made. An example he gave is labor strife. What Mr. Woods is proposing is that the companies put in a small amount of equity while the U.S. lends a lot of money. If the risks materialize, the U.S. will lose three times as much as the companies and collect nothing but a fee. We hope the operation will be viable, but the U.S. cannot protect itself against expropriation, for example.

 B1
ED
Returning to his earlier presentation, he said the opposite end of the spectrum would be to have Ghana do the whole project with U.S. help and with the companies hired to run it.

In Mr. Chayes' view, Mr. Woods should be on the side of the Government in giving his advice because he would not want the companies to be covered against all contingencies. Then there would be no incentive for the companies to maintain good relations with Ghana. In fact, with all the risks covered, the companies have the opposite motive and can dump the plant at their convenience. Mr. Chayes said the general climate would affect profits and Mr. Woods should want to see a structure which would provide a clear incentive to avoid friction.

On behalf of the Treasury Department, Mr. Chayes emphasized that the Government's offer consisted of an entire package. Since it does not appear that tax sparing can be achieved, the Government wishes to avoid a situation in which agreement on the package would be followed by additional requests from the companies for offsets for tax-sparing. After some further discussion of this point by Mr. Surrey, the companies were advised that the question of the form of the stockholders' participation is still open. (The question which had been raised by Mr. Calhoun related to the possibility that the companies might provide their participation in the form of stockholders' advances for tax purposes.)

DECLASSIFIED

CONFIDENTIAL

- 7 -

Participants

Abram Chayes, Legal Adviser, Department of State
Harold Linder, President, Export-Import Bank
Frank Coffin, Managing Director, Development Loan Fund
Arthur McLaughlin, Deputy Director for Operations, DLF
Stanley Surrey, Assistant Secretary of Treasury for Tax Policy
Ralph Hirschtritt, Treasury Department
Peyton Kerr, Deputy Assistant Secretary of State for Economic Affairs
George Kenney, OFD/ED
Robert Eisenberg, AF/W
Chad Calhoun, Vice President, Kaiser Industries
Lloyd Cutler, Attorney for Aluminum Companies
George Woods, First Boston Corporation
Ronald Sullivan, Sullivan and Cromwell
San Stern, Sullivan and Cromwell

DECLASSIFIED